



DEPARTMENT OF
FINANCE

GRAY DAVIS, GOVERNOR

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November 7, 2001

Ms. Jane I. Henderson, Ph.D., Executive Director
California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

Dear Dr. Henderson:

FINAL AUDIT REPORT ON THE CHILDREN AND FAMILIES TRUST FUND AND RELATED FUNDS

Enclosed is the final report on our financial audit of the Children and Families Trust Fund and related funds, for the fiscal year ended June 30, 2001. Our audit was performed under interagency agreement number CCFC-6851, between the California Children and Families Commission and the Department of Finance.

There were no audit findings or issues requiring a response. At your request, we are issuing the report as final.

We appreciate the assistance of Commission staff with our audit. If you have any questions or comments regarding this report, please contact Richard R. Sierra, Manager, or Doris M. Walsh, Supervisor, at (916) 322-2985.

Sincerely,

Samuel E. Hull, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Joseph Munso, Chief Deputy Director, Children and Families Commission
Mr. Brian Hobson, Chief, Administrative Division, Children and Families Commission

A F_{INANCIAL} S_{TATEMENT} A_{UDIT}

California Children and Families Commission Children and Families Trust Fund and Related Funds

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The Department of Finance, Office of State Audits and Evaluations, performed this audit under Health and Safety Code Section 130150. The purpose was to audit the Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis of the Children and Families Trust Fund and related funds (Funds) for the 12 months ended June 30, 2001. The financial audit objectives were to:

- Express an opinion on the financial statements based on our audit, conducted in accordance with standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States.
- Verify that the financial statements were prepared in conformity with the accounting practices as prescribed by the State of California, which comprise a comprehensive basis of accounting other than generally accepted accounting principles.
- As necessary, report on internal control weaknesses and provide recommendations for improving internal control over the Funds' operations.

This report is a public record. Requests for copies should be made to the California Children and Families Commission.

STAFF:

Richard R. Sierra, CPA
Manager

Doris M. Walsh
Supervisor

Becky McAllister
Maureen Pasag

Proposition 10 was passed by the voters of the State of California on November 3, 1998. It funds early childhood development programs from revenues generated by increases in the State excise tax on cigarettes and other tobacco products. These programs are either provided by the State California Children and Families Commission (Commission) or the local county commissions. When Proposition 10 became law on January 1, 1999, the State collected: 1) a surcharge of 50 cents for every cigarette pack distributed, and 2) an additional excise tax on other tobacco products. Upon passage, the California Children and Families Trust Fund and related funds (Funds) and Health and Safety Code Sections 130100-130155 were established. The Health and Safety Code is cited as the California Children and Families Act of 1998 (Act).

The Act's intent is to provide, on a community-by-community basis, a comprehensive, integrated, and collaborative system of early childhood development services for all children prenatal to five years of age. The Act establishes that 80 percent of total revenues are to be allocated to county commissions based on a percentage of the number of live births recorded in the relevant county in proportion to the entire number of live births recorded in California. This portion of the revenue is deposited into the Counties Children and Families Fund (0585). The remaining 20 percent is distributed to the Commission for allocation to six separate funds as follows:

- Fund 0631 – Mass Media (6%)
- Fund 0634 – Education (5%)
- Fund 0636 – Child Care (3%)
- Fund 0637 – Research and Development (3%)
- Fund 0638 – Administration (1%)
- Fund 0639 – Unallocated (2%)

The role of the Commission is to: (1) oversee and support the county commissions' efforts through services, programs, and funding so that each county commission is achieving its goals and objectives; (2) distribute monies to county commissions in a timely and equitable manner; and (3) perform the functions as set forth by the Act.



INDEPENDENT AUDITOR'S REPORT

Ms. Jane I. Henderson, Ph.D., Executive Director
California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

We have audited the accompanying Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis of the Children and Families Trust Fund and related funds (Funds), for the fiscal year ended June 30, 2001. These financial statements are the responsibility of the California Children and Families Commission's (Commission) management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, these financial statements were prepared in conformity with the accounting practices as prescribed by the State of California, which comprise a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis present fairly, in all material respects, the results of the Commission's operations for the fiscal year ended June 30, 2001, in conformity with the basis of accounting described in Note 2 to the financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2001, on our consideration of the Commission's internal control over the Children and Families Trust Fund and related Funds, and on our tests of its compliance with applicable laws and regulations. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of the Commission and the Legislature, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in cursive script that reads "Samuel E. Hull". The signature is written in black ink and is positioned above the printed name and title.

Samuel E. Hull, CPA
Chief, Office of State Audits and Evaluations
(916) 322-2985

October 15, 2001

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Children and Families Trust Fund (0623)
Statement of Revenues, Expenditures,
and Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenues: (Note 3)

Cigarette Tax	\$ 649,540,571
Interest on Investments	2,539,929
Escheated Checks	<u>1,143</u>
Total Revenue	652,081,643

Expenditures: (Note 4) (741,000)

Other Financing Uses:

Operating Transfers Out (Note 5) (651,340,643)

Excess of Revenue Over Expenditures and
Other Financing Uses 0

Fund Balance, July 1, 2000 0

Fund Balance, June 30, 2001 \$ 0

The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Counties Children and Families Fund (0585)
Statement of Revenues, Expenditures,
and Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenues: (Note 3)

Interest on Investments	\$ 3,011,257
Escheated Checks	<u>13,708</u>
Total Revenue	3,024,965

Expenditures: (Note 4) (504,714,727)

Other Financing Sources:

Operating Transfers In (Note 5)	<u>501,872,514</u>
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Excess of Revenue and Other Financing Sources
Over Expenditures 182,752

Fund Balance, July 1, 2000 98,704,817

Fund Balance, June 30, 2001 \$ 98,887,569

The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Mass Media Communications Fund (0631)
Statement of Revenues, Expenditures,
and Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenue: (Note 3)

Interest on Investments	\$ 3,526,142
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Expenditures: (Note 4)	(41,313,706)
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Other Financing Sources:

Operating Transfers In (Note 5)	<u>37,640,439</u>
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Excess of Expenditures Over Revenue and Other Financing Sources	(147,125)
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Fund Balance, July 1, 2000	<u>52,335,448</u>
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Fund Balance, June 30, 2001	<u>\$ 52,188,323</u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Education Fund (0634)
Statement of Revenues, Expenditures, and
Changes In Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenue: (Note 3)

Interest on Investments	\$ 3,256,588
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Expenditures: (Note 4)	(15,183,494)
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Other Financing Sources:

Operating Transfers In (Note 5)	<u>31,367,032</u>
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Excess of Revenue and Other Financing Sources Over Expenditures	19,440,126
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Fund Balance, July 1, 2000	<u>46,828,130</u>
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Fund Balance, June 30, 2001	<u>\$ 66,268,256</u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Child Care Fund (0636)
Statement of Revenues, Expenditures, and
Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenue: (Note 3)

Interest on Investments	\$ 2,367,439
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Expenditures: (Note 4)	(7,213,189)
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Other Financing Sources:

Operating Transfers In (Note 5)	<u>18,820,219</u>
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Excess of Revenue and Other Financing Sources Over Expenditures	13,974,469
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Fund Balance, July 1, 2000	<u>33,191,692</u>
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Fund Balance, June 30, 2001	<u>\$ 47,166,161</u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Research and Development Fund (0637)
Statement of Revenues, Expenditures, and
Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenue: (Note 3)

Interest on Investments	\$ 2,398,995
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Expenditures: (Note 4)	(5,501,232)
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Other Financing Sources:

Operating Transfers In (Note 5)	<u>18,820,219</u>
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Excess of Revenue and Other Financing Sources Over Expenditures	15,717,982
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Fund Balance, July 1, 2000	<u>33,180,803</u>
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Fund Balance, June 30, 2001	<u>\$ 48,898,785</u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Administration Fund (0638)
Statement of Revenues, Expenditures, and
Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenue: (Note 3)

Interest on Investments	\$ 564,326
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Expenditures: (Note 4)	(4,041,322)
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Other Financing Sources:

Operating Transfers In (Note 5)	<u>6,273,406</u>
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Excess of Revenue and Other Financing Sources Over Expenditures	2,796,410
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Fund Balance, July 1, 2000	<u>8,813,032</u>
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Fund Balance, June 30, 2001	<u>\$ 11,609,442</u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE-STATUTORY BASIS

**California Children and Families Commission
Unallocated Fund (0639)
Statement of Revenues, Expenditures, and
Changes in Fund Balance-Statutory Basis
For the Year Ended June 30, 2001**

Revenue: (Note 3)

Interest on Investments	\$ 1,417,239
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Expenditures: (Note 4)	(7,645,433)
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Other Financing Sources:

Operating Transfers In (Note 5)	<u>12,546,813</u>
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Excess of Revenue and Other Financing Sources Over Expenditures	6,318,619
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Fund Balance, July 1, 2000	<u>21,513,751</u>
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Fund Balance, June 30, 2001	<u>\$ 27,832,370</u>
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The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

California Children and Families Commission Children and Families Trust Fund and Related Funds Notes to Financial Statements For the Year Ended June 30, 2001

NOTE 1 Definition of Reporting Entity and Operations

The Children and Families Trust Fund and related funds (Funds) were created by the California Children and Families Act of 1998 (Act). The Act is intended to promote, support, and improve the early development of children from the prenatal stage to five years of age. The programs authorized by this Act are administered by the California Children and Families Commission (Commission) and by county children and families commissions.

Effective January 1, 1999, Section 30131.2 of the Revenue and Taxation Code authorized the Fund 0623 (Fund) to collect: (1) 50 cents for each cigarette pack distributed, and (2) an additional surtax for other tobacco products. The surtax for other tobacco products was imposed upon every distributor, based on the wholesale cost of these products, at a tax rate determined annually by the State Board of Equalization. This tax rate is equivalent to the rate of tax imposed on cigarettes. The Board of Equalization collects and deposits the cigarette tax and the additional surtax for other tobacco products into the Fund. The Fund was established as a pass-through clearing account, and is a shared fund with the Commission. All Board of Equalization revenues and administrative expenditures related to Proposition 10 are funneled through this account. The remaining monies are then allocated to the county commissions through Fund 0585 and to the six related Commission Funds (Funds 0631, 0634, 0636, 0637, 0638, and 0639).

These monies are allocated and appropriated from Fund 0623: 80 percent to the county commissions and 20 percent to the State Commission. Each county commission receives a portion of the monies equal to the percentage of the number of live births recorded in the relevant county (for the most recent reporting period) in proportion to the entire number of live births recorded in California (for the same period). Vital statistics compiled by the Department of Health Services are used.

The Commission's 20 percent is allocated to six different Funds:

Mass Media Communications Fund 0631 (6%)
Education Fund 0634 (5%)
Child Care Fund 0636 (3%)
Research and Development Fund 0637 (3%)
Administration Fund 0638 (1%)
Unallocated Fund 0639 (2%)

Expenditures in the Funds must be spent in accordance with the provisions of the Health and Safety Code, Section 130105 (d), subsections (A) through (F).

NOTE 2 Summary of Significant Accounting Policies

A. Basis of Accounting

The accompanying financial statements have been prepared on the modified accrual basis of accounting. This method follows the statutory accounting guidelines prescribed by the State of California, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under this method, revenues are recorded when they become measurable and available, and expenditures are recorded at the time the corresponding liability is incurred.

B. Budgetary Accounting

The Act states that the Fund monies are continuously appropriated without regard to fiscal year.

C. Fund Accounting

The Funds are classified as special revenue funds for financial reporting purposes. A special revenue fund is used to account for the proceeds of specific revenue sources that are legally restricted to expenditure for specified purposes.

NOTE 3 Revenues

Revenues consist of the cigarette tax collected on every cigarette pack and other tobacco products distributed, and interest income earned in the Surplus Money Investment Fund. In addition, unclaimed checks are escheated as revenue to the issuing fund.

NOTE 4 Expenditures

During the fiscal year, expenditures are recognized when claims to the State Controller are filed against the appropriations, or when monies are transferred to the State Payroll Revolving Fund for the payment of salaries and wages. Valid expense commitments, including encumbrances, are accrued as accounts payable at June 30.

NOTE 5 Interfund Transfers

Legally authorized transfers between State funds are reported on the Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis as “Operating Transfers,” and are accounted for as reductions or increases in the Fund Balance.

“Operating Transfers Out” of the Children and Families Trust Fund 0623 equals the sum of the statutorily required backfill of the Proposition 99 health-related education or research programs and the Breast Cancer Fund, and the “Operating Transfers In” for the six related Funds. “Operating Transfers In” for the six related Funds consists of the applicable percentage of Fund 0623 revenues, which include cigarette tax revenues and interest income.

The backfill is required by the Health and Safety Code Section 130105 which states, “The State Board of Equalization shall determine within one year of the passage of this act the effect that additional taxes imposed on cigarettes and tobacco products by this act has on the consumption of cigarettes and tobacco products in this state. To the extent that a decrease in consumption is determined by the State Board of Equalization to be the direct result of additional taxes imposed by this act, the State Board of Equalization shall determine the fiscal effect the decrease in consumption has on the funding of any Proposition 99 (the Tobacco Tax and Health Protection Act of 1988) State health-related education or research programs in effect as of November 1, 1998, and the Breast Cancer Fund programs that are funded by excise taxes on cigarettes and tobacco products. Funds shall be transferred from the California Children and Families Trust Fund to those affected programs as necessary to offset the revenue decrease directly resulting from the imposition of additional taxes by this act. Such reimbursements shall occur, and at such times, as determined necessary to further the intent of this subdivision.”

Historically, backfill is calculated in October. An approval from the Board of Equalization’s Directors must be obtained before the transfer of funds. Backfill amounts transferred for fiscal years 1998-99 and 1999-00 totaled \$12.6 million and \$24 million, respectively.

NOTE 6 Fund Balance

Fund balance represents the difference between assets and liabilities of the Funds.

NOTE 7 Contingent Liabilities

The Commission is involved in three refund actions that challenge the constitutionality of Proposition 10. The actions are:

- California Association of Retail Tobacconists (CART), et al. v. Board of Equalization, et al.
- Cigarettes Cheaper!, et al. v. Board of Equalization, et al.
- McLane/Suneast, et al. v. Board of Equalization, et al.

CART and Cigarettes Cheaper! allege that Proposition 10 violates 11 sections of the California Constitution and related provisions of the law. McLane/Suneast challenges only the “double tax” aspect of Proposition 10. CART and Cigarettes Cheaper! are seeking refunds of over \$5 million and \$4 million, respectively. McLane/Suneast’s claim is between \$500,000 and \$1 million. The three cases were successfully defended and are now pending at the Court of Appeal. Should the State lose on appeal, there is exposure as to the entire \$750 million per year collected under Proposition 10 together with interest, which could amount to several billion dollars by the time the case is finally resolved.

REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Ms. Jane I. Henderson, Ph.D., Executive Director
California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

We have audited the Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis of the Children and Families Trust Fund and related Funds (Funds), for the fiscal year ended June 30, 2001, and have issued our report thereon dated October 15, 2001. We performed this audit under an interagency agreement with the California Children and Families Commission (Commission). We conducted our audit in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Commission's Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Statements of Revenues, Expenditures, and Changes in Fund Balance-Statutory Basis and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Commission and the Legislature, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in cursive script, reading "Samuel E. Hull".

Samuel E. Hull, CPA
Chief, Office of State Audits and Evaluations
(916) 322-2985

October 15, 2001